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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

November 5, 1993

William Caton
Acting Secretary
Federal Communications Commission
Mail Stop Code 1170
1919 M Street, N.W., Room 222
Washington, D.C. 20554

Dear Mr. Caton:

Re: CC Docket No. 93-240

On behalf of Pacific Bell and Nevada Bell, please find enclosed an original and six copies of their "Reply Comments" in the above proceeding.

Please stamp and return the provided copy to confirm your receipt. You may contact me should you have any questions or require additional information concerning this matter.

Sincerely,

Sherry Herauf

Enclosures

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Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of Accounting for Judgments and Other Costs Associated with Litigation	))))	CC Docket No. 93-240

REPLY COMMENTS OF PACIFIC BELL AND NEVADA BELL

Pacific Bell and Nevada Bell (the "Pacific Companies") respectfully submit these Reply Comments on the comments filed on October 15, 1993 in response to the Commission's Notice of Proposed Rulemaking ("NPRM") released September 9, 1993 in this proceeding.

I. The comments do not support the proposed rule changes.

The overwhelming majority of comments filed in response to the Commission's NPRM do not support the rule changes proposed for the accounting and ratemaking treatment of the costs of judgments, settlements and other expenses associated with antitrust and other federal and state statutory violations. Instead, the comments provide articulate and well developed reasons for rejecting the accounting and ratemaking rule changes. Commentors provide sound analysis showing that the proposed changes are not supported by the Litton Accounting and

Litigation Costs decisions;[1] that the proposed rules are inconsistent with the Commission's objective to conform a carrier's accounting practices to generally acceptable accounting practices (GAAP); and that the proposed rules would result in administrative burden to the Commission and carriers that is not justified by commensurate ratepayer benefit. The Pacific Companies will not reiterate these arguments. Instead we will limit our response to the comments filed by the only supporter of the rule changes, MCI.[2]

2. The sole comment in support of the rule changes does not provide reasoned analysis.

The comments by MCI do not provide reasoned analysis for its support.[3] In fact, MCI fails to discuss a fundamental problem with the proposed treatment that contributed to the remand of the previous accounting and ratemaking rules -- that the Commission had not shown that a presumption of

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[1] Mountain States Telephone and Telegraph Co. v. FCC, 939 F.2d 1021 (D.C. Cir. 1991) ("Litton Accounting"); Mountain States Telephone and Telegraph Co. v. FCC, 939 F.2d 1035 (D.C. Cir. 1991) ("Litigation Costs").

[2] The comments of Scott J. Rafferty raise issues related to the ratemaking treatment of affiliate litigation costs but do not specifically discuss the changes proposed by the NPRM. Moreover, the comments focus on the treatment of affiliate transaction costs which is already fully covered by section 64.902 of the Commission's rules whether the costs are for litigation or other services provided by an affiliate to the regulated carrier. 47 C.F.R. §64.902.

[3] Comments of MCI Telecommunications Corporation, dated October 15, 1993 ("MCI Comments").

unreasonableness for litigation costs other than for federal antitrust actions is supportable.[4]

By repeatedly quoting the traditional and appropriate test for including expenses in ratemaking,[5] MCI implies that the proposed rule changes support that test. The facts are to the contrary. The proposed rules preclude analysis based on the traditional test and instead presume that the costs are unreasonable. MCI does not explain how the proposed rule changes address, let alone overcome, that fundamental problem.

MCI also supports the proposed rules concerning settlements but MCI's comments are inconsistent and contradictory. For example, MCI agrees that all settlements should be excluded from ratemaking unless settlement can be shown to be in the ratepayers' interest.[6] But, MCI also agrees with the Commission's attempt to create an incentive for early settlement because "the amount to be recovered from ratepayers would be smaller than the amount required to fully litigate the

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[4] Litigation Costs, 939 F.2d at 1402.

[5] For example, MCI's Comments provides the following: "...regulators routinely analyze the costs in terms of whether they are 'used and useful' to the ratepayers" (page 3); "...the Communications Act imposes upon the Commission the duty of regulating the rates chargeable for interstate telecommunications service with a view to ensuring that they are just and reasonable." (page 6); "Regulatory authorities may disallow expenses actually incurred in the company's operation when the challenged expense is found to be exorbitant, unnecessary, wasteful, extravagant, or incurred in the abuse of discretion or in bad faith...." (page 6).

[6] MCI Comments, p. 7.

case."[7] The amount of litigation costs saved (which is the result of an early settlement) is exactly what the Commission defines as the nuisance value. Yet, MCI explicitly opposes the carrier's recovery of the nuisance value of a case.[8] The Commission should reject MCI's analysis.

Finally, MCI's support for the proposal to accrue litigation defense costs in a deferral account is based on an unsupportable premise. MCI believes that because carriers could not presume that expenses placed in a deferral account would be recoverable, the problem of retroactive ratemaking would disappear. MCI is off base. Retroactive ratemaking is unrelated to a carrier's expectations of recovery but results when future rates are established to correct past earnings performance.[9] Moreover, MCI does not provide any basis for the Commission to decide to reverse its previous position which rejected deferral

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[7] MCI Comments, p. 8.

[8] Id.

[9] See, e.g., Nader v. FCC, 520 F.2d 182, 101 (D.C. Cir 1975).

accounting. Nor does MCI offer any reasoning to support the adoption of an accounting rule that is contrary to GAAP.[10]

Conclusion

The record developed in response to the Commission's NPRM shows overwhelming opposition to the proposed accounting and ratemaking treatment. The Pacific Companies respectfully urge the Commission to terminate this proceeding without adopting the proposed changes. As stated in our Comments,[11] whether costs are properly included for ratemaking must be determined by the traditional ratemaking standards of necessity and reasonableness. The presumption that judgments, settlement and litigation expenses incurred as the result of violations of federal and state laws are unreasonable is not supportable.

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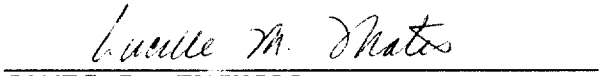
[10] MCI's assertion that shareholders of a nonregulated company would bear the risk of monetary loss as a result of an adverse judgment is not necessarily true. MCI Comments, pp. 4-5. These costs would be considered an expense of doing business. The company would decide how to treat the costs. It could very well decide to raise prices to cover the additional expense.

[11] Comments of Pacific Bell and Nevada Bell, dated October 15, 1993.

Moreover, the costs of defense are an ordinary cost of business and should be accounted for as incurred.

Respectfully submitted,

PACIFIC BELL
NEVADA BELL



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Date: November 5, 1993

CERTIFICATE OF SERVICE

I, Agnes M. Lowe, hereby certify that a copy of the foregoing Reply Comments of Pacific Bell and Nevada Bell regarding CC Docket No. 93-240 was served on each of the parties on the attached list on November 5, 1993, by first class United States mail, postage prepaid, or by hand delivery.

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